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COURT OF APPEAL, FOURTH APPELLATE DISTRICT

DIVISION ONE

STATE OF CALIFORNIA

DAVID L. DUNCAN, Plaintiff, Cross-defendant and Appellant, v. OTAY WATER DISTRICT, Defendant, Cross-complainant and Appellant.	D038924 (Super. Ct. No. 720189)

APPEALS from a judgment of the Superior Court of San Diego County, E. Mac Amos, Jr., Judge. Affirmed in part and reversed in part.

In this second appeal in an action arising out of a dispute regarding sewer connections and monthly sewer service charges for land known as the "Singing Hills property," plaintiff David L. Duncan and defendant Otay Water District (the District)

appeal from a judgment on retrial following our reversal in part of a judgment in favor of the District on the original court trial.[1]

Duncan brought this action seeking a declaration of his rights regarding (1) sewer connections he allegedly received as part of his purchase of the Singing Hills property from the Resolution Trust Corporation (RTC)/Federal Deposit Insurance Corporation (FDIC) in its role as receiver of a failed savings institution;[2] (2) his obligation to pay monthly sewer service charges; and (3) his asserted right to sell back to the District certain unused sewer connections. The District on the other hand argued that Duncan did not receive any sewer connection rights as a part of that purchase or, alternatively, if he did, that along with those rights came obligations for accrued and unpaid monthly sewer service charges. The District also argued Duncan did not have the unilateral right to force it to buy back unused sewer connections.

At the first court trial, the court[3] found in favor of the District. The court first found that no sewer connection rights were validly transferred to Duncan pursuant to his purchase of the Singing Hills property as (1) the sewer connections could not be transferred separately from the underlying sewer purchase agreement between the District

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1 Much of the factual and procedural background of this opinion comes from our previous unpublished opinion in this matter, *David L. Duncan v. Otay Water District* (July 25, 2000, DO33898).

2 The RTC was the original receiver, replaced by the FDIC in 1996. Accordingly, these entities together will hereafter be referred to as the "RTC/FDIC."

3 The Honorable Robert J. O'Neill.

and a prior owner of the property (Sewer Purchase Agreement); (2) the RTC/FDIC never acquired the connections and thus could not transfer them to Duncan; and (3) the RTC/FDIC did not validly transfer the sewer connections to Duncan. The court also found that the monthly sewer charges were proper, but that since Duncan received no sewer connection rights, he was not obligated to pay them. Finally, the court found the District was only obligated to repurchase unused sewer connections if it had an available third party purchaser.

Duncan appealed, first asserting that the court erred in finding the sewer connections could not be transferred separately from the Sewer Purchase Agreement, and any obligations to pay monthly sewer service charges thereunder, because the sewer connections were vested property rights, to be held for the benefit of the Singing Hills property. Second, by operation of federal law, the RTC/FDIC obtained ownership and control of the sewer connections. Third, under federal law, and the terms of the sale transaction, the RTC/FDIC validly transferred the sewer connections to him. Fourth, under state and federal law, the monthly sewer charges were invalid and unenforceable. Finally, Duncan contended that under the plain language of the subject document, the District was obligated to refund the costs of any unused sewer connections.

We affirmed in part and reversed in part, holding (1) the sewer connections were transferred to Duncan pursuant to his purchase of the Singing Hills property from the RTC/FDIC; (2) the monthly sewer service charges were valid and accompanied the transfer of the subject property to Duncan, making him liable for those charges; and (3) under the plain language of the Sewer Purchase Agreement, the District was obligated to

repurchase certain unused sewer connections, regardless of the availability of a third party purchaser. We remanded this matter for a determination of the damages related to monthly sewer service charges owing by Duncan to the District and the repurchase of unused sewer connections, and any defenses raised by the parties relating to these respective items of damage.

At the court retrial,[4] Duncan asserted that the District was required to repurchase all 253 of his unused sewer connections that he tendered to the District in June 1996. He also contended that any monthly sewer charges that accrued more than four years before the District filed its cross-complaint in this action seeking their payment were barred by the statute of limitations. The District argued that at the time Duncan tendered his sewer connections, it was only obligated to repurchase those sewer connections he could not use because of governmental action relating to the development process. The District also argued that it should be allowed to offset any time-barred sewer charges against Duncan's claim for repurchase of the unused sewer connections.

The court found that the District was only obligated to repurchase those sewer connections that were unused because of governmental action resulting in a reduced number of building units. Based upon this finding the court declared that the District was only obligated to repurchase 103 of the 253 sewer connections Duncan tendered in June 1996 for damages to Duncan in the amount of $594,994.73. The court then found that all of the District's monthly sewer charges accruing before 1994 were time barred. The

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4 The retrial was heard by the Honorable E. Mac Amos, Jr.

District's timely claim for monthly sewer charges resulted in damages to the District of $422,223.20, which reduced Duncan's recovery to $172,771.53. However, the court also found that the District was entitled to an "equitable set-off" of the time-barred charges, which totaled $626,338.75, up to the amount of Duncan's remaining damages. This resulted in net zero recovery for each side.

Duncan appeals from the judgment on retrial asserting the court erred by (1) finding the District was required to repurchase only 103 unused sewer connections as of June 1996, and (2) allowing the District to set off its time-barred sewer charges against his damages. The District also appeals, contending that the court erred by (1) first setting off its timely sewer charge claim against Duncan's damages, as opposed to first applying its time-barred claims; and (2) failing to add interest on its claims when applying the offset.

We conclude that the court correctly ruled that the District was only required to repurchase 103 of the sewer connections Duncan tendered in June 1996. We further conclude, however, that the court erred in awarding a setoff of the District's time-barred monthly sewer charges against the damages awarded to Duncan for repurchased sewer connections because this defense was never pleaded in the District's answer. Accordingly, we reverse that portion of the judgment awarding a setoff to the District, remand the matter for a recalculation of damages, and affirm the judgment in all other respects.

FACTUAL BACKGROUND

A. *The Sewer Purchase Agreement*

In January 1985, the District entered into a Sewer Purchase Agreement with Singing Hills Village Company (SHVC). SHVC was a joint venture, 50 percent owned by 1415 Stratford, Ltd. (Stratford), a California limited partnership, and 50 percent owned by Meracor Development Corporation (Meracor),[5] an Arizona corporation that was a wholly owned subsidiary of Merabank, a savings and loan association.

Under the Sewer Purchase Agreement, the District sold to SHVC 504 sewer connections to the District's Willow Glen Drive trunk sewer (Willow Glen Sewer) system. The total purchase price was $2,671,200, which consisted of (1) $1,411,200 for SHVC's pro rata share of the construction costs to extend the Willow Glen Sewer system to serve the Singing Hills property; and (b) $1,260,000 for sewer connections in the District's sewer system.

To finance the purchase of the sewer connections, SHVC obtained a $5 million loan from Meracor. The loan was secured by a deed of trust on the Singing Hills property.

It is undisputed that SHVC made all construction and connection charge payments required under the Sewer Purchase Agreement. It is also undisputed that the District has used and benefited from the $2,671,200 paid by SHVC.

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5 The original partner was First Service Corporation. Subsequently, First Service Corporation became Meracor.

Under the Sewer Purchase Agreement, the sewer connection rights "vested" when the agreement and all related documents were signed by the parties. The sewer connection rights were "guaranteed" and to be held by the District "for the benefit of [the Singing Hills] property."

The Sewer Purchase Agreement prohibits the sale or transfer of the sewer connection rights except that (1) SHVC could assign the rights to the "[q]ualified [f]inancial [i]nstitution" that financed the purchase price or (2) SHVC could assign the rights to a subsequent purchaser of the property with the District's advance approval.

Paragraph 10 of the Sewer Purchase Agreement also gave the District the exclusive right to repurchase and resell any unused and returned sewer connection rights, set an amount for the repurchase of each unused connection, and conditioned return upon full payment by SHVC of each connection that had been purchased:

> "Should Purchaser desire to sell all or any portion of the Connection Rights purchased under this Agreement, they must be returned to District for resale; however, no Connection Rights may be returned for resale unless full payment has been made to the District for all EDUs [equivalent dwelling units] of service being purchased under this Agreement. District shall then resell the returned Connection Rights on a first-come-first-served basis. District shall pay Purchaser the amount set forth in the schedule in Exhibit 'C' for the returned Connection Rights. No refund shall be due or payable to Purchaser for any of the EDU construction charge previously paid."

In addition to the original purchase price, the Sewer Purchase Agreement provides that SHVC was obligated to begin making monthly sewer service charge payments at the earlier of two dates: (1) when service was initially furnished, or (2) five years after the date of the Sewer Purchase Agreement.

After the execution of the Sewer Purchase Agreement, the District and SHVC entered into an addendum to that agreement (Addendum). The purpose of the Addendum as stated in the document was to recognize that while SHVC planned to construct as many as 504 dwelling units, the San Diego County Board of Supervisors (the County) might reduce the allowable units during the "final governmental approval" process for the Singing Hills property. Accordingly, the Addendum provided that SHVC was entitled to sell back to the District those unused sewer connections that did not receive "final governmental approval," so long as full payment had first been made for all sewer connections purchased:

> "Purchaser anticipates acquiring capacity rights for each phase sufficient to serve the number of dwelling units specified in the Singing Hills Specific Plan. If, however, Purchaser seeks or receives final governmental approval for a reduced number of dwelling units in any phase, Purchaser shall be entitled to return to District for resale any unused Connection Rights so long as full payment has been made [to] the District for all [sewer connections] being purchased for that particular phase."

The Addendum further provided that SHVC could transfer its sewer connection rights to a purchaser of the Singing Hills property without District preapproval on two conditions. First, the District was to be given advance written notice of the transfer. Second, the prospective purchaser had to agree to assume the obligations of the Sewer Purchase Agreement in a manner "substantially the same" as a form appended as exhibit D to the Sewer Purchase Agreement. The Addendum further provided that the District's consent to such a transfer would "not be unreasonably withheld."

B. *Postpurchase Developments Regarding the Sewer Connection Rights*

Following the signing of the Sewer Purchase Agreement, the County approved development of only 401 of SHVC's proposed 504 dwelling units on the Singing Hills property, reducing the amount of sewer connections rights that could be used by 103. SHVC thereafter sold 251 of its 504 sewer connection rights, leaving it with 253 remaining.

SHVC never connected to the sewer system, and the monthly service fees began accruing in January 1990. However, SHVC did not pay the monthly fees.

C. *RTC/FDIC Receivership of Merabank*

At the same time as the monthly sewer service fees began accruing in January 1990, the RTC was appointed receiver of Merabank, the lender on the Singing Hills property and owner of Meracor, the one-half owner of SHVC. In June 1991, Meracor assigned its interests in the Singing Hills property to the RTC.

In 1992, the District began notifying SHVC regarding the unpaid monthly sewer charges. SHVC's representative met on a couple of occasions with the District's representative to discuss the outstanding charges. Based upon these meetings, the District understood that SHVC was not paying the monthly sewer charges because of its financial problems.

In 1994, Stratford (the other 50 percent owner of SHVC) gave the RTC special power of attorney for SHVC. In 1995, both SHVC and Stratford quitclaimed the Singing Hills property to the RTC.

D. *The RTC's Communications with the District*

The District began contacting the RTC in September 1994 about SHVC's unpaid and accrued monthly sewer service fees. The District provided the RTC with documentation of the amount of the outstanding monthly fees (approximately $621,000 at that time) and the rate at which they were accruing monthly (approximately $7,500 per month). The RTC indicated that it was attempting to sell the Singing Hills property and would include the charges to the buyer of the Singing Hills property. The District elected to forgo a collection suit at that time that might jeopardize the efforts to sell the property.

E. *Sale of Property to Duncan*

The RTC put the Singing Hills property out to a bid in October 1995. The bid package disclosed and documented the unpaid and accruing monthly fees for the sewer connections. Duncan, in reviewing the bid documents, concluded that the sewer connections had some potential for value in the form of a repurchase by the District if they were unused. Duncan was also aware that the District had a claim for monthly sewer charges in the range of $600,000 to $650,000.

The bid of Kent Ranch Development Company, Inc. (Kent) was accepted and in November 1995 Kent entered into a purchase and sale agreement with the RTC (RTC Sale Agreement) for the purchase of the Singing Hills property in the amount of $140,000.[6] The RTC and Kent then entered into a second addendum to the RTC Sale Agreement (Second Addendum). The Second Addendum provided that the sale of the

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6 Duncan was the president of Kent.

Singing Hills property would convey to Kent "any and all rights acquired by [the RTC] in connection with the property that is the subject of the [RTC Sale] Agreement, including but not limited to any and all *sewer connection rights,* to the extent if any [the RTC] holds such rights." (Italics added.) The Second Addendum also contained a provision, titled "Additional Obligations of Buyer/Otay Water District," which states that Kent "may be obligated to pay at Closing all amounts owing to [the Water District], if any . . . ," and in which Kent acknowledged that "the sum of approximately $650,000.00 is presently claimed by [the Water District] to be due and owing to [the Water District] and that such sum claimed due increases in the amount of approximately $7,500.00 per month." Kent also agreed that the RTC would "not be obligated to remove any lien, take any action with respect to such claims or otherwise, or pay any amounts claimed owing to [the Water District]." In the final provision of the Second Addendum, Kent assigned its interest in the RTC Sale Agreement to its president (the plaintiff here), Duncan.

F. *Commitment Forms and Final Maps*

Shortly after the close of escrow on Duncan's purchase of the Singing Hills property, SHVC's tentative maps were to expire. Duncan needed County sewer service commitment forms (commitment forms) to be able to record a final map on the property. The commitment forms established the amount of sewer connections committed to property and reflected the maximum possible developable units under the final map. The District's signature on the commitment forms were a representation by the District it had committed a specific number of sewer connections for the development identified in the

final map. It was the District's policy not to sign off on commitment forms where the developer had not fully paid for its sewer connections.

Before the close of escrow Duncan's representative[7] requested in writing that the District execute commitment forms for 150 sewer connections. The District initially refused to issue the commitment forms, arguing that Duncan needed to pay all outstanding monthly sewer charges first. However, the District then agreed to issue the commitment letters, the parties agreeing that (1) Duncan would not argue that the issuance constituted a waiver by the District of its rights to collect the monthly sewer fees; and (2) the District would not argue that the issuance prejudiced Duncan's rights regarding his responsibility for such fees, and any other "fees and charges" related to the Singing Hills property. The District issued the commitment forms in January 1996, and Duncan transferred them to the County before the expiration date for the tentative maps. With this documentation in place, the County recorded final maps on the Singing Hills property in April 1996.

G. *Tender of Sewer Connections to District*

In June 1996, Duncan tendered all 253 remaining sewer connections to the District for repurchase and a refund. Duncan, however, in his tender admitted that "150 [sewer connections] have tentative approval and final approval is being sought from Resource Agencies." Duncan also admitted that only "103 units were disapproved by the [County]" as of that tender. In conjunction with his tender, Duncan also offered to pay

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7 Chris Oldham, Duncan's project manager for the Singing Hills property.

approximately $25,000 in monthly sewer charges that had accrued during his period of ownership of the Singing Hills property.

In response, the District took the position that Duncan was only entitled to return the 103 unused sewer connections lost during SHVC's tentative map process. The District also offered to credit the repurchase price of the 103 unused sewer connections against the outstanding monthly sewer charges.

PROCEDURAL BACKGROUND

A. *The Pleadings*

In April 1998, Duncan filed a complaint alleging five causes of action for declaratory relief. The first cause of action sought declarations that (1) Duncan was not a party to the Sewer Purchase Agreement; (2) Duncan had not agreed to be bound by any obligations created under the Sewer Purchase Agreement; (3) the Sewer Purchase Agreement had not been recorded; and (4) the monthly fees and District preapproval of transfers were invalid. The second cause of action sought a declaration that Duncan had not breached any of the terms of the Sewer Purchase Agreement. The third cause of action sought a declaration that the sewer connection rights were vested rights that passed to Duncan with the deed to the Singing Hills property. The fourth cause of action for declaratory relief sought a declaration that the RTC Sale Agreement and its addenda were valid and enforceable, and also did not obligate Duncan to pay any monthly fees. The fifth cause of action sought a declaration that Duncan was entitled to use of the sewer connection rights.

In June 1998, the District filed its answer. In that answer, the District asserted various affirmative defenses, but did not assert that it was entitled to a setoff of Duncan's claimed sewer connection refund against the monthly sewer charges. At the same time, the District filed a cross-complaint stating two causes of action. The first cause of action sought a declaration that SHVC's rights under the Sewer Purchase Agreement had been extinguished by a breach of that agreement. The second cause of action sought an alternative declaration that if the sewer connection rights were validly transferred to Duncan, Duncan was also subject to the obligations to pay the monthly fees. The second cause of action sought a damage award in the amount of the unpaid monthly sewer fees. However, the cross-complaint also did not request a setoff of any of those monies as against any damages awarded to Duncan.

B. *First Trial*

In January 1999 a bench trial on the parties' respective claims proceeded. After four days of testimony, submission of exhibits, and arguments by counsel, the matter was submitted. In May 1999 the court issued its ruling and written statement of decision.

The court first found that transfer of the sewer connection rights could only be accomplished by the methods specified in the Sewer Purchase Agreement, which did not include transfer by a deed to the Singing Hills property. The court also found that the sewer connection rights could not be assigned separately from the Sewer Purchase Agreement.

The court found the monthly fees were valid and proper. The court also found that under the language of the Sewer Purchase Agreement Addendum, an owner of unused

sewer connection rights could return them to the District if all required payments to the District had been made. However, the court found the District would only have to pay for those unused sewer connection rights if in fact the District resold them to a third party purchaser.

The court then found that Stratford's and Meracor's interests in the Sewer Purchase Agreement had not been validly assigned to Duncan by the RTC. Based upon this finding that Duncan had not received any interest under the Sewer Purchase Agreement, the court found Duncan was not responsible for any unpaid and accruing monthly fees. However, the court found that if the interests of the RTC or Stratford were ever validly transferred to Duncan, he would take them subject to the outstanding and accruing monthly fee obligations.

The court thereafter entered judgment and Duncan timely appealed.

C. *First Appeal (Case No. D033898)*

On Duncan's first appeal he contended that the court erred in all respects. First, Duncan asserted that the court erred in finding the sewer connections could not be transferred separately from the Sewer Purchase Agreement, and any obligations to pay monthly sewer service charges thereunder, because the sewer connections were vested property rights, to be held for the benefit of the Singing Hills property. Second, Duncan asserted that by operation of federal law, the RTC/FDIC obtained ownership and control of the sewer connections. Third, Duncan contended that under federal law, and the terms of the sale transaction, the RTC/FDIC validly transferred the sewer connections to him. Fourth, Duncan asserted that under state and federal law, the monthly sewer charges are

invalid and unenforceable. Finally, Duncan contended that under the plain language of the subject document, the District was obligated to refund the costs of any unused sewer connections.

In our opinion in Duncan's first appeal we held that Duncan had validly acquired the sewer connections through the RTC's assignment of the Sewer Purchase Agreement and Addendum, and reversed the trial court on this issue. However, we also concluded that the monthly sewer charges were valid and enforceable. Finally, we held that the court erred on the repurchase issue, holding that the Addendum clearly provided that the District was obligated to repurchase any unused sewer connections that could not be used because "final governmental approval" reduced the amount of dwelling units that could be built. In so holding, we also concluded that the Addendum to the Sewer Purchase Agreement, not paragraph 10 of that document, governed the District's repurchase obligations. We held that paragraph 10 "was revised in the Addendum to the Sewer Purchase Agreement." We then concluded that the Addendum "was added to the Sewer Purchase Agreement because the purchaser was uncertain as to the amount of dwelling units that would ultimately be approved, and how many sewer connections would be needed. Therefore, the parties agreed that if 'final governmental approval' reduced the amount of dwelling units, the purchaser could return the difference." We remanded the matter "for a determination of the damages related to monthly sewer service charges owing by Duncan to the District and the repurchase of unused sewer connections, and any defenses raised by the parties relating to these respective items of damage."

D. *Second Trial*

The second court trial began in May 2001. Duncan asserted that the District was obligated to repurchase all 253 EDU's when he tendered them in June 1996. Duncan also asserted that the monthly sewer charges that accrued more than four years prior to the filing date of the District's cross-complaint were time barred. Duncan contended that the District could not offset any time-barred charges against his claim. Finally, Duncan asserted that the District could not charge any sewer fees that accrued after the date he tendered the unused sewer connections to the District.

The District contended that as of the time of Duncan's tender it was only obligated to repurchase the 103 sewer connections Duncan could not use because of the government's reduction of allowed dwelling units on the property. The District also asserted that while the monthly sewer charges from January 1990 through June 1994 were time barred, it should be allowed an "equitable setoff" of these charges against the amount awarded to Duncan for the repurchase of sewer connections. Finally, the District asserted that it was entitled to collect monthly sewer fees (1) on all 253 sewer connections from June 1994 until the June 1996 tender; (2) on 150 sewer connections from the June 1996 tender until the authorities further reduced the number of allowable units; and (3) on 134 sewer connections from that date until these remaining sewer connections were transferred to third parties.

At trial, the court heard testimony from several witnesses involved in the transactions and received relevant documentary evidence. Following closing arguments by counsel, the court took the matter under submission.

The court then rendered a statement of decision.[8] In rendering its decision, the court rejected Duncan's assertion that paragraph 10 of the Sewer Purchase Agreement obligated the District to repurchase "any sewer connections that are tendered to the [D]istrict." The court also found that paragraph 10 gave the District a right, not an obligation, to repurchase sewer connections. However, the court found that the Addendum modified paragraph 10 so that the District was obligated to repurchase sewer connections "where there has been a final government approval for a reduced number of units."

The court found that since only 103 of the sewer connections had been eliminated by authorities at the time of Duncan's June 1996 tender, the remaining 150 could not be tendered for repurchase as of that date. The court also found that the District was required to repurchase an additional 16 sewer connections when the conservation bank/open space easement reduced the allowable number of units by that number.[9] The court thus concluded that Duncan was entitled to damages in the amount of $594,994.73 for repurchases to which he was entitled, plus interest.

With regard to monthly sewer charges, the court first found that all charges accruing before June 1994 were barred by the statute of limitations. The court then analyzed whether it should impose an equitable offset of these time-barred charges

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8 The parties stipulated that the court's oral ruling in open court would constitute the statement of decision.

9 There is no dispute on this appeal concerning those 16 additional unused sewer connections.

against Duncan's damages. The court first noted that both Duncan's claim and the time-barred monthly sewer charges arose from the "same contract or series of transactions." The court also found that it was not necessary to prove any wrongdoing by Duncan in order to impose an offset. The court then concluded that SHVC's financial problems at the time the charges arose amounted to an insolvency that would support an equitable offset.

The court also weighed the "equities" in the case to determine if it should allow an offset in this case. The court found the equities favoring the District were that: (1) SHVC had been billed as early as 1992 and 1993 for the monthly sewer charges; (2) Duncan knew of the District's claims when he purchased the property; (3) the monthly charges were used for sewer maintenance that would be necessary regardless of whether Duncan used the sewer connections; and (4) the Sewer Purchase Agreement was clear as to the obligation to pay these monthly charges. On Duncan's side the court found the equities to be (1) the District knew as early as 1988 that 103 of the sewer connections could not be used; and (2) the District had not presented evidence of the exact relationship between sewer maintenance costs and the amount of outstanding monthly sewer charges. The court concluded that, based upon these factors, an offset of the time-barred charges was appropriate.

The court then calculated the offset. The court first subtracted the District's timely claim for monthly sewer charges of $422,223.20 from Duncan's claim for $594,994.73, leaving Duncan with a net recovery of $172,771.53. The court then applied the time-

barred charges, which exceeded Duncan's net recovery, reducing his recovery to $0, as the District could not use an offset to recover affirmative relief.

E. *Objections to Statement of Decision*

Following the court's statement of decision, Duncan filed an objection. Duncan first objected that the court's calculation of his damages was too low because it failed to include the elimination of an additional 26 sewer connections. Duncan also objected to the calculation of the District's damages as (1) the offset included interest; (2) the District should not use any offsets after March 1995 as the District could have sued the RTC or Duncan after that time; and (3) the amount of offset should not include any time-barred charges accruing on the 103 sewer connections after they were eliminated by the County.

The District opposed Duncan's objection, with the exception of Duncan's assertion that the calculation of his damages did not include 26 eliminated sewer connections. The District opposed the remainder of the objections, asserting that Duncan's objections misapprehended the proper application of offsets. The District also for the first time asserted that it was not only entitled to an equitable setoff, but also a statutory offset under Code of Civil Procedure section 431.70.[10] The District also objected to the statement of decision, asserting the court misapplied the offset. The District contended that the court should have first applied the offset to Duncan's claim, reducing Duncan's

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10 All further statutory references are to the Code of Civil Procedure unless otherwise specified.

claim to $0, allowing the District to then recover the $422,223.20 in timely monthly sewer charges claims.

Duncan responded to the District's objections to the statement of decision. Among other things, Duncan asserted that a setoff under section 431.70 was not appropriate as the District never asserted such an affirmative defense in its answer.

The court agreed that the statement of decision should be corrected to include 26 eliminated sewer connections that were not originally included by the court, increasing Duncan's damages to $704,775.06. The court also adjusted the District's damages to reflect monthly sewer charges on the 26 sewer connections prior to their elimination. The court also amended the statement of decision to state that only interest prior to June 1994 could be included in the offset of time-barred claims. The court rejected all of Duncan's other objections and the District's objections. The adjustments to the damages had no effect on the $0 net recovery to either side.

Judgment was entered in August 2001. Both parties timely appealed.

DISCUSSION

I. *DUNCAN'S APPEAL*

A. *Repurchase of Sewer Connections*

Duncan first contends that the court erred in determining that as of June 1996 he was only entitled to return to the District for repurchase of the 103 sewer connections that were eliminated because of the reduction by the County in the amount of units he could build. We reject this contention.

1. *Standard of review*

The interpretation of written instruments is ordinarily a judicial function unless the interpretation turns on the credibility of extrinsic evidence. (*Parsons v. Bristol Development Co.* (1965) 62 Cal.2d 861, 865.) Accordingly, appellate courts are not bound by a trial court's interpretation of a written instrument, and the de novo standard of review applies, where, as here, the trial court's interpretation is "'based solely upon the terms of the written instrument without the aid of evidence [citations], where there is no conflict in the evidence [citations], or a determination has been made upon incompetent evidence [citation].'" (*Ibid.*)

2. *Principles of contract interpretation*

"'The primary object of all interpretation is to ascertain and carry out the intention of the parties. [Citations.] All the rules of interpretation must be considered and each given its proper weight, where necessary, in order to arrive at the true effect of the instrument. [Citation.]'" (*City of Manhattan Beach v. Superior Court* (1996) 13 Cal.4th 232, 238 (*City of Manhattan Beach*).)

Further, it must be recognized that "'since the language of each instrument is sui generis, no bright-line rules of construction are available to aid us in this endeavor. "Analysis of cases on this subject makes it abundantly clear that it is impossible to lay down an invariable and universal rule of construction. [Citation.] Every transaction must be considered individually." [Citation.]'" (*City of Manhattan Beach, supra,* 13 Cal.4th at p. 243.)

In order to ascertain the intent of the parties, we must, of course, first resort to the language of the document itself. (*Machado v. Southern Pacific Transportation Co.* (1991) 233 Cal.App.3d 347, 359.) Further, courts may consider extrinsic evidence where it will assist in determining a contract's meaning: "'The test of admissibility of extrinsic evidence to explain the meaning of a written instrument is not whether it appears to the court to be plain and unambiguous on its face, but whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible. [Citations.]' [Citation.]" (*City of Manhattan Beach, supra,* 13 Cal.4th at p. 246.)

In interpreting a contract, we look to the whole of a contract with an eye to giving effect to every provision: "The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other." (Civ. Code, § 1641.) Further, "[a] contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties." (Civ. Code, § 1643.)

3. *Analysis*

Duncan asserts that the terms of paragraph 10 of the Sewer Purchase Agreement compels the conclusion that the District was required to repurchase all 253 sewer connections he tendered to the District in June 1996. We conclude that the Addendum to the Sewer Purchase Agreement governs the parties' rights and obligations as to repurchase of sewer connections, and that the Addendum only allowed Duncan to tender

for repurchase the 103 sewer connections he could not use as of June 1996 because that is the number by which the County had reduced the number of building units as of that date.

Paragraph 10 of the Sewer Purchase Agreement, as discussed, *ante*, provides that if Duncan decided to sell "all or any" of the sewer connection rights, "they must be returned to the District for resale." Paragraph 10 also provides that the "District shall then resell the returned Connection Rights on a first-come-first-served basis" and that the "District shall pay Purchaser the amount set forth in the schedule in Exhibit C for the returned Connection Rights."

However, as we noted in our previous opinion in this matter, because Duncan "and the District wished to 'clarify the rights as outlined in the Purchase Agreement' . . . the repurchase language of the Sewer Purchase Agreement was revised in the Addendum." We further concluded that the Addendum "was added to the Sewer Purchase Agreement because the purchaser was uncertain as to the amount of dwelling units that would ultimately be approved, and how many sewer connections would be needed. Therefore the parties agreed that if 'final governmental approval' reduced the amount of dwelling units, the purchaser could return the difference." We also referred in that opinion to the District's obligation to repurchase "excess sewer connections" and remanded the matter for consideration of Duncan's claim for repurchase of "excess" connection rights.

Thus, we held in our previous opinion that the Addendum revised the terms of paragraph 10 to require the District to repurchase only those sewer connections that could not be used because "final governmental approval" reduced the amount of dwelling units. That amount was the 103 sewer connections tendered by Duncan in June 1996. Those

sewer connections could not be used because the County's approval of the tentative map for the Singing Hills property reduced the density from 504 units to 401 units. Duncan's commitment forms and final maps still allowed development with all remaining 150 sewer connections as of the date of that tender.

Our findings in the prior appeal must, under the doctrine of "law of the case," be followed in this appeal. (*Clemente v. State of California* (1985) 40 Cal.3d 202, 211-212.) Thus, Duncan cannot, as he does here, attempt to argue that the Addendum does not control the parties' rights and obligations regarding repurchase, and cannot avoid our previous pronouncement that the Addendum only required the District to purchase those sewer connections eliminated by governmental action that reduced the amount of dwelling units that could be built on the Singing Hills property.

In fact, in his tender letter Duncan admitted that "103 units were disapproved by the [County] . . . [,] 150 have tentative approval and final approval is being sought from Resource Agencies but is by no means certain." Duncan then went on to "request that the Water District repurchase the 103 unit connections which were lost by the [County's] action effective March 11, 1998 to reduce the allowable number of residential units within the Singing Hills Specific Plan Area from 504 units to 401 units." Thus, Duncan recognized at the time of his tender that the terms of the Addendum, not paragraph 10, governed his rights for a repurchase under the Sewer Purchase Agreement, and that repurchase was triggered by the County's decision to reduce the number of units that

could be built.[11] As we noted in our previous opinion, this evidence of Duncan's conduct before a dispute arose as to the obligation to repurchase excess sewer connections is relevant to interpreting the meaning of the Addendum. (*Oceanside 84, Ltd. v. Fidelity Federal Bank* (1997) 56 Cal.App.4th 1441, 1449.)

Duncan asserts that even if the Addendum controlled his repurchase rights, he still had the right to return the other 150 sewer connections because the Addendum allowed him to return any "unused" sewer connections, and they were "unused" because as of that time he had not developed his property and connected to the sewer system. This contention is unavailing.

The term "unused" in the Addendum immediately follows the "seeks or receives final governmental approval for a reduced number of dwelling units in any phase" language. Thus, it is clear that the term "unused" means those that were eliminated because Duncan did not "seek or receive [] . . . governmental approval" for their use. As of June 1996, those were the 103 sewer connections eliminated when the County reduced the number of dwelling units. It is clear that as of that date, by virtue of Duncan's tender letter, the commitment forms and his final maps, he was still seeking governmental approval for the remaining 150 sewer connections.

It matters not that final map approval and commitment letters did not, as Duncan asserts, ensure that the sewer connections would ever be used. Again, the term "unused"

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[11] In his tender letter Duncan did also, pursuant to the Addendum, assert that the District was also required to repurchase "the currently unused 150 connections." This issue will be discussed, *post*.

in the Addendum refers not to whether or not the sewer connections were currently being utilized or would ever be. It refers to those that were eliminated by governmental reduction of dwelling units.

Duncan contends that the sewer connections cannot be considered used after receiving final maps or commitment letters because even after receiving these items, there are several hurdles, environmental or otherwise, that could prevent development, meaning that he might never be able to return the sewer connections for a refund and at the same time would "have to pay monthly charges on them forever." This assertion misses the point.

If in fact the prospects of development became problematic or remote and Duncan was unwilling to pay the monthly sewer charges, he could have abandoned his final maps and commitments letters and returned his sewer connections for repurchase because he would no longer be "seeking" final governmental approval for those sewer connections. The alternative would be to go forward with development and return for repurchase those sewer connections as they were eliminated by governmental actions reducing building units. That is precisely the scenario that the parties bargained for in the Sewer Purchase Agreement and Addendum. The purchaser was given a five-year window before monthly sewer charges would begin to obtain development approval. The purchaser took the risk after that time that the development would still be profitable if it had to begin paying monthly charges on sewer connections that might never actually be connected to the system.

Duncan also asserts that the District is barred from asserting that the final maps issued to Duncan prevented him from tendering for repurchase the 150 sewer connections not eliminated by the County's reduction in building units. Duncan bases this contention on negotiations that he had with the District concerning whether they would issue commitment letters necessary for approval of final maps when he had outstanding monthly sewer charges. In particular, Duncan relies upon a January 1996 letter from his counsel[12] memorializing the parties' agreement that the District would issue the commitment letters in return for an acknowledgement by Duncan that he would not claim the District waived the right to pursue those charges by issuing the commitment letters. The letter provides in part:

> "[W]e are negotiating with the County of San Diego and Otay Water District to fulfill certain conditions that will allow our clients to record the approved tentative maps on the Singing Hills property. We need the District's assistance in recording the maps by February 10, 1996.
>
> "It is my understanding that the District will work with our clients to obtain the information necessary to record the tentative maps; however, you do not want any action taken by the District to prejudice the District's position that sewer service fees are required to be paid by our clients under the purchase agreement. Without agreeing to the District's position, we are willing to agree to the following:
>
> "1. Our clients will not take the position that the District has waived, or is estopped from asserting, its claims for reimbursement of sewer service fees by issuing 'will serve' letters[13] in connection

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12 Mark J. Dillon.

13 "Will serve" letters is another name for commitment letters.

with the recordation of the tentative maps for the Singing Hills property.

"2. Our clients will not use the District's issuance of 'will serve' letters in any argument regarding the asserted obligation to pay sewer service fees under the purchase agreement or any other fees or charges applicable to the Singing Hills property.

"3. The District will not assert that our clients have waived or prejudiced their position regarding the purchase agreement payment dispute, *or any other dispute concerning fees or charges applicable to the Singing Hills property*, by requesting issuance of the 'will serve' letters.

". . . . . .

"If this letter meets with your approval, please immediately issue 'will serve' letters, and instruct the engineering staff to complete processing plans and cost estimates . . . so that our clients will be able to timely record the tentative maps." (Italics added.)

The District issued the commitment letters three days after this letter from Duncan's attorney.

Duncan asserts that under paragraph 3 of this letter, the District agreed that it would not rely upon the issuance of the commitment letters to argue that he was not entitled to tender for repurchase 150 sewer connections. This contention is unavailing.

The dispute at issue at the time of this letter was solely related to the monthly sewer charges. No dispute existed as to tender and repurchase of sewer connections as Duncan did not even tender those connections until June 1996, five months later. Further, the reference to disputes concerning "fees and charges" cannot reasonably be interpreted to cover a dispute concerning the tender and repurchase of the sewer connections. The sewer connections were paid for, and there were no outstanding "fees

and charges" as to those connections. A tender and repurchase cannot be said to be synonymous with the term "fees and charges." It also would be illogical for the District, in a letter agreeing to provide commitment letters, to at the same time waive its right to object to a tender on the basis of Duncan's pursuit of those very commitment letters.

Duncan asserts that even if the Addendum "*modified or revised* Paragraph 10, it did not *replace or super[s]ede* it." However, even if it is true that an amendment does not completely replace or supersede the original contract, we have already held, as we did in the first appeal, that the Addendum is controlling on the issue of Duncan's entitlement to tender unused sewer connections. It is clear that the Addendum only requires repurchase of those sewer connections lost through governmental reduction (or Duncan's voluntary reduction) of dwelling units. Anything inconsistent with this interpretation found in paragraph 10 of the Sewer Purchase Agreement *was* "*replaced or super[s]eded*" by the Addendum.

Last, Duncan contends that exhibit C to the Sewer Purchase Agreement, which governs the amount to be paid for repurchased sewer connections, demonstrates the parties intended to allow tender of all sewer connections. We reject this contention.

Exhibit C only shows the schedule of sewer connections purchased, and also the amount the District was to pay, according to the year of the tender, for a repurchase. Because the schedule shows a total repurchase amount for each year for a repurchase of all sewer connections sold, Duncan concludes that therefore the District contemplated a return of *all* sewer connections. However, merely because the repurchase schedule contemplated the *eventuality* of a repurchase of all sewer connections, this does not mean

that the District was, under the Sewer Purchase Agreement and Addendum, *required* to repurchase all sewer connections regardless of the timing and circumstances. For example, if Duncan elected to forgo all further development, thereby seeking final governmental approval for no further dwelling units, Duncan would be entitled to return all sewer connections he tendered. This would trigger the schedule dictating the amount he would be paid for a repurchase. However, nothing in exhibit C specifies that if the requirements of the Addendum were *not* met for any given year, the District would still be required to repurchase all of Duncan's sewer connections.

In sum, we conclude that the court did not err in finding that as of June 1996 when Duncan tendered his sewer connections the District was only required to accept for repayment the 103 sewer connections he could not use because of final governmental approval of a reduced number of dwelling units.

B. *Setoff of District's Time-Barred Claims*

Duncan contends that the court erred in granting the District an equitable setoff of its time-barred sewer fees against Duncan's claim for monies from the repurchase of his sewer connection rights. We conclude that because the District never raised the affirmative defense of a setoff in its answer, the court erred in granting such relief to the District and we reverse that portion of the court's ruling.

1. *Standard of review*

As the court's decision to allow an equitable setoff was an exercise of discretion, we review that decision to determine if the decision "'exceeds the bounds of reason, all of the circumstances before it being considered.'" (*Denham v. Superior Court* (1970) 2

Cal.3d 557, 566.) Under the abuse of discretion standard, we will not substitute our decision for that of the trial court. When two or more inferences can reasonably be deduced from the facts, the court order may not be overturned. (*Walker v. Superior Court* (1991) 53 Cal.3d 257, 272.)

2. *Analysis*

The principle of setoff as a defense to a creditor's claim was recognized as early as the 17th century. (*Granberry v. Islay Investments* (1995) 9 Cal.4th 738, 743.) The doctrine "was founded on the equitable principle that 'either party to a transaction involving mutual debts and credits can strike a balance, holding himself owing or entitled only to the net difference, ...' [Citation.]" (*Id.* at p. 744.) The right of setoff has now been codified in section 431.70, which provides in part:

> "Where cross-demands for money have existed between persons at any point in time when neither demand was barred by the statute of limitations, and an action is thereafter commenced by one such person, the other person may assert in the answer the defense of payment in that the two demands are compensated so far as they equal each other, notwithstanding that an independent action asserting the person's claim would at the time of filing the answer be barred by the statute of limitations. If the cross-demand would otherwise be barred by the statute of limitations, the relief accorded under this section shall not exceed the value of the relief granted to the other party."

It has been held, however, that notwithstanding section 431.70, the right to a setoff exists independent of this statute, based upon equitable principles: "The right exists independently of statute and rests upon the inherent power of the court to do justice to the parties before it." (*Salaman v. Bolt* (1977) 74 Cal.App.3d 907, 918.) However, while that may be the general rule, the right to obtain a setoff for claims barred by the statute of

limitations *has* been codified in section 431.70 and a party seeking such a setoff must therefore comply with its provisions. (*Construction Protective Services, Inc. v. TIG Specialty Ins. Co.* (2002) 29 Cal.4th 189, 197 (*CPSI*); *Granberry v. Islay Investments, supra,* 9 Cal.4th at p. 744; *Carmel Valley Fire Protection Dist. v. State of California* (1987) 190 Cal.App.3d 521, 550; Legis. Revision Com. com., 14A West's Ann. Code Civ. Proc. (1973 ed.) foll. § 431.70, p. 413 ["Section 431.70 ameliorates the effect of the statute of limitations"].)

Prior to 1972, former section 440 (the predecessor to § 431.70) provided:

> "When cross-demands have existed between persons under such circumstances that, if one had brought an action against the other, a counter-claim could have been set up, the two demands shall be deemed compensated, so far as they equal each other, and neither can be deprived of the benefit thereof by the assignment or death of the other."

In *Jones v. Mortimer* (1946) 28 Cal.2d 627 (*Jones*) the California Supreme Court held that this former setoff statute, although not explicitly so providing, allowed a setoff despite a statute of limitations defense to the claim sought to be used to negate the other party's claim. In *Jones*, the setoff was asserted by an insolvent savings and loan association. (*Id.* at p. 629.) The California Building and Loan Commissioner, who had taken over the insolvent defendant, levied an assessment against its shareholders in the amount of $100 per share. (*Ibid.*) Jones, who owned four shares, was levied $400, but never paid the assessment. (*Ibid.*) Jones in the meantime had filed an action against the association to recover for services rendered in the amount of $1,536.10. (*Ibid.*) The commissioner attempted to set off the $400 assessment against this amount. (*Ibid.*)

The California Supreme Court held the setoff was proper under section 440, despite Jones's assertion that it was barred by the statute of limitations. (*Jones, supra,* 28 Cal.2d at pp. 632-634.) In so doing, the high court reasoned: "Defendant could have set up the assessment as a counterclaim [to Jones's original claim] when the two coexisted and there was no question about the statute of limitation on either claim. The next step [under section 440] is that the demands are *compensated.* That can mean nothing more or less than that each of the claimants is *paid* to the extent that their claims are equal. To the extent that they are *paid*, how can the statute of limitation run on either of them?" (*Id.* at p. 633.)

The Court of Appeal in *Sunrise Produce Co. v. Malovich* (1950) 101 Cal.App.2d 520 (*Sunrise*) followed the holding in *Jones,* applying it to its own facts. In *Sunrise*, the plaintiff was suing for payment for goods sold to the defendant. (*Id.* at p. 521.) The defendant admitted the allegations in the complaint, but counterclaimed for $40,450 in trailer rentals. (*Ibid.*) However, the statute of limitations had run on trailer rental claim and the trial court granted the plaintiff's motion to strike the counterclaim and entered summary judgment in favor of the plaintiff. (*Ibid.*)

The Court of Appeal reversed, relying on *Jones.* The appellate court concluded, as did the high court in *Jones*, that the statute of limitations did not prevent the defendant from asserting a setoff as a defense to the plaintiff's claim. (*Jones, supra,* 101 Cal.App.2d at pp. 523-524.) In so doing, the Court of Appeal explained: "This is a fair rule as it provides in effect that plaintiff's and defendant's claims, having coexisted in point of time, are deemed compensated to the extent that they equal each other, and the

statutes of limitation should not bar the defendant's right to show that compensation." (*Id.* at p. 523.)

Recently, in *CPSI, supra,* 29 Cal.4th at pages 195-197, the California Supreme Court reviewed the *Jones* and *Sunrise* decisions in light of section 431.70 and its predecessor section 440. The high court noted that "former section 440 said nothing about the statute of limitations" (*CPSI, supra,* at p. 195) and concluded that "the Legislature repealed former section 440 in 1971 . . . and enacted in its place section 431.70, *codifying the rule of Jones and Sunrise Produce* but adding the following sentence: 'If the cross-demand would otherwise be barred by the statute of limitations, the relief accorded under this section shall not exceed the value of the relief granted to the other party.'" (*CPSI, supra,* at p. 197, italics added.) That section 431.70 is a codification of the common law with respect to time-barred setoff claims has also been recognized in earlier authority and the legislative history of section 431.70. (See *Carmel Valley Fire Protection Dist. v. State of California, supra,* 190 Cal.App.3d at p. 550 [§ 431.70 is a "partial" codification of equitable setoff doctrine]; Legis. Com. com., 14A West's Ann. Code Civ. Proc., *supra*, foll. § 431.70, p. 413 ["Section 431.70 ameliorates the effect of the statute of limitations"].)

Thus, the foregoing authority makes clear that what was previously a common law equitable right to a setoff of time-barred claims is now provided for by statute in section 431.70. Accordingly, any claim for such a setoff must comply with the terms of section 431.70. The requirements of that section include (1) that both parties had cross-demands that existed at the same time when neither was barred by the statute of limitations; and (2)

that the party asserting the time-barred setoff may not recover more than the other party's claim. (§ 431.70.)

Moreover, under its terms, a claim for a setoff of a time-barred claim under section 431.70 must be raised as an affirmative defense in an answer to the complaint. (§ 431.70.) This itself is a codification of the common law rule as to equitable setoffs that "[a] setoff is generally a new matter that must be affirmatively pleaded." (*Title Ins. Co. v. State Bd. of Equalization* (1992) 4 Cal.4th 715, 731 (*TIC*) [party barred from raising setoff by failing to plead it as affirmative defense in answer].)[14]

As detailed, *ante*, the District failed to raise the defense of offset in its answer. In fact, the District did not raise a claim of "equitable setoff" until trial of this matter, when Duncan asserted that many of the District's monthly charges asserted in its cross-complaint were barred by the statute of limitations. The claim to a setoff under section 431.70 was raised for the first time *after* trial, and Duncan objected to this defense as not having been pleaded in the District's answer. As such, the District's claim of a setoff is barred, as such a claim is a "new matter which must be affirmatively pleaded" in its answer. (*TIC, supra,* 4 Cal.4th at p. 731; § 431.70.) Indeed, this rule is applicable not only to a defense of "equitable" setoff, but also more generally to any equitable defense. (*Hayward Lbr. & Inv. Co. v. Const. Prod. Corp.* (1953) 117 Cal.App.2d 221, 228.) Any

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14 The only exception to this rule, not applicable here, is where the plaintiff pleads common counts. Because of the uninformative nature of such a complaint, a general denial is sufficient to raise almost any kind of defense, including a setoff. (*TIC, supra,* 4 Cal.4th at pp. 731-732.)

equitable defense must be pleaded "with some particularity" in the answer or it is waived. (*Ibid.*)

The District attempts to avoid this rule by arguing that an offset may also be raised by way of a cross-complaint and that its cross-complaint adequately pleaded a setoff by pleading its claim for all monthly sewer charges. This assertion fails for several reasons.

First, a claim to a setoff of time-barred charges was *not* pleaded in the District's cross-complaint. The cross-complaint only alleges a general right to the monthly sewer charges, not a setoff of time-barred charges that it was entitled to under either equitable principles or section 431.70. Nothing in the cross-complaint put Duncan on notice that the District was seeking such relief. Indeed, the District never raised a claim of setoff under section 431.70, which, as discussed, *ante*, is the only procedural mechanism for a claim of setoff of time-barred charges, until *after* the *second* trial of this matter, in response to Duncan's objection to the court's statement of decision.

Further, the District is incorrect that a setoff may be pleaded in a cross-complaint. In support of this contention the District cites *American Nat. Bank v. Stanfill* (1988) 205 Cal.App.3d 1089 (*ANB*), which, without any discussion or analysis stated: "Claims of a setoff can be raised by way of affirmative defense *as well as cross-complaint*." (*Id.* at p. 1097, italics added.) This statement is incorrect. First, in support of this statement the court in *ANB* cites to section 431.70, which states that a claim of setoff is to be asserted in a defendant's answer, not a cross-complaint. *ANB* also cites to 1 California Civil Procedure Before Trial (Cont.Ed.Bar 1977) section 12.17, page 436, in support of this proposition. However, a review of the 2002 version of this treatise, and the section (now

§ 32.45) cited in *ANB* does not support, and in fact contradicts, *ANB's* statement. That portion of the treatise states that: "Any issue as to 'set-offs,' *e.g.*, overpayments by the defendant in the past, represents new matter that must be pleaded as an affirmative defense." (2 Cal. Civil Procedure Before Trial (Cont.Ed.Bar 3d ed. 2002) § 32.45, pp. 1020-1021.) Section 32.45 of the treatise continues: "A claim for affirmative relief, not merely for set-off, requires the pleading of a separate cross-complaint and may not be included in an answer." (*Id.* at p. 1021.) Thus, the treatise not only does not support the District's position and the statement in *ANB*, it actually recognizes that setoffs are affirmative defenses that must be raised in the answer, and that claims for affirmative relief are separate and different items that must be raised in a cross-complaint.

This is consistent with the nature and distinctions between defensive setoffs and claims for affirmative relief set forth in cross-complaints. A cross-complaint consists of claims for affirmative relief against another party. (*Keith G. v. Suzanne H.* (1998) 62 Cal.App.4th 853, 860.) "A setoff, by contrast, is not a claim for relief. It occurs at the end of the litigation and is a means by which a debtor may satisfy in whole or in part a judgment or claim held against him out of a judgment or claim which he has subsequently acquired against his judgment creditor." (*Id.* at pp. 860-861.) Thus, a setoff is not a claim for relief appropriately raised by cross-complaint, but rather is an affirmative defense that must be raised in an answer to the complaint. To the extent that *ANB's* statement that a setoff may be raised by way of cross-complaint is inconsistent

with the rule as stated by the California Supreme Court in *TIC* and in section 431.70, we decline to follow it as contrary to California law.[15]

The effect of a failure to plead an affirmative defense is clear. That defense is waived. (§ 430.80; *Jetty v. Craco* (1954) 123 Cal.App.2d 876, 880.) Further, where, as here, the defense is not pleaded at all, it is waived even if evidence comes in at trial on the issue without objection. (*San Fernando Valley C. of C. v. Thomas* (1954) 123 Cal.App.2d 348, 350-351.) Accordingly, the District's claim of a setoff, whether characterized as "equitable" or brought under section 431.70, was not properly before the court on the partial retrial of this matter, and we must reverse that portion of the judgment awarding the District a setoff of its time-barred monthly sewer charges against Duncan's claim for repurchase of sewer connections.[16]

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15 At any rate, it appears that the statement in *ANB* is dictum as the Court of Appeal there noted that the defendant had pleaded a setoff in his answer, and the court's statement had nothing to do with the issue presented and the court's holding. (See *ANB, supra,* 205 Cal.App.3d at p. 1097.)

16 Based upon this holding we need not address the District's appeal asserting that the court erred in the manner it calculated the setoff defense.

DISPOSITION

That portion of the judgment awarding a setoff of the District's time-barred monthly sewer charges against Duncan's award for the repurchase of sewer connections is reversed, and the matter is remanded for a recalculation of damages. In all other respects, the judgment is affirmed. Each side is to bear its own costs on appeal.

NARES, J.

WE CONCUR:

KREMER, P. J.

BENKE, J.